

**Letter Report: Oversight of the Philadelphia  
Lockbox Bank Should Be Improved**

**January 2001**

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DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

January 31, 2001

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

A handwritten signature in black ink, reading "Pamela J. Gardiner".

FROM: Pamela J. Gardiner  
Deputy Inspector General for Audit

SUBJECT: Final Letter Report - Oversight of the Philadelphia Lockbox Bank  
Should Be Improved

This report presents the results of our review of the controls over the lockbox program in the Philadelphia lockbox bank. In summary, we found that the lockbox bank timely deposited all the taxpayer payments we reviewed and complied with most of the security guidelines to safeguard the payments. Opportunities exist to improve the lockbox program in the areas of tax return sorting and Internal Revenue Service (IRS) oversight of bank activities.

Our recommendations will provide the following measurable benefit on tax administration: cost savings of approximately \$109,056 will result from the IRS not conducting a 100 percent review of the bank's sorting of tax returns. Appendix III of this report provides a detailed description of this benefit, which will be included in our Semiannual Report to the Congress.

Management's response was due on January 25, 2001. As of January 29, 2001, management had not responded to the draft report.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions, or your staff may call Walter Arrison, Associate Inspector General for Audit (Wage and Investment Income Programs), at (770) 936-4590.

## **Objective and Scope**

*The objective was to determine whether controls provided reasonable assurance that taxpayer payments were processed within established guidelines.*

The overall objective of this review was to determine whether controls over the lockbox program in a Philadelphia bank provided reasonable assurance that taxpayer payments were processed in accordance with established guidelines. To achieve our objective, we:

- Reviewed judgmental samples of 147 tax payments and 200 tax returns received by the bank between April 2000 and June 2000 to determine whether they were processed in accordance with established guidelines and were safeguarded from theft, unauthorized use, and disclosure.
- Held discussions with local lockbox bank (Bank One) and Internal Revenue Service (IRS) officials and reviewed procedures and reports to determine whether the bank correctly performed other required services, such as shipping tax returns and providing oversight of bank activities.
- Visited the local lockbox bank on June 8, 2000, to observe and evaluate the controls over the physical security of taxpayer payments, tax returns, and other taxpayer data.

Audit work was performed at the Philadelphia Submission Processing Center (PSPC) and the Philadelphia lockbox bank during June 2000. This audit was performed in accordance with *Government Auditing Standards*.

Major contributors to this report are listed in Appendix I. Appendix II contains the Report Distribution List.

## **Background**

*The lockbox bank deposits tax payments and performs other services, which allows the IRS to process tax returns and tax payments quicker.*

The IRS lockbox program consists of commercial banks that have contracted with the Financial Management Service (FMS), another government agency, to process tax payments. This program was designed to accelerate the deposit of tax payments by having taxpayers send their payments to commercial banks rather than to the IRS. According to the IRS, from January 2000 through April 2000, the bank processed over 3.3 million tax payments totaling over \$16 billion. The bank also received over 1 million tax returns.

The Statement of Work (SOW) and Lockbox Processing Guidelines are agreements between the FMS and the bank detailing the specific services that the bank will perform for the IRS. These services include tasks that the IRS would otherwise have to do, such as ensuring that checks are made payable to the IRS or the United States Treasury, providing security over the tax payments and taxpayer data, and creating computer tapes of payment transactions. The bank also receives, sorts, and ships tax returns to the IRS.

## **Results**

*The IRS lockbox bank timely deposited all of the reviewed tax payments.*

The bank timely deposited all 147 taxpayer payments that we reviewed.<sup>1</sup> Ninety-nine percent of those payments also posted correctly to taxpayers' accounts.<sup>2</sup>

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<sup>1</sup> The SOW and Internal Revenue Manual (IRM) require that tax payments be deposited within 24 hours of receipt during non-peak periods and peak periods other than April for scannable documents, within 48 hours of receipt during peak periods other than April for non-scannable documents, and by April 30, 2000, during April.

<sup>2</sup> The remaining 1 percent included 2 payments. One posted to the wrong tax period but was subsequently corrected. The other never posted to the taxpayer's account. We referred this case to the Treasury Inspector General for Tax Administration's Office of Investigations.

## **Letter Report: Oversight of the Philadelphia Lockbox Bank Should Be Improved**

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*The IRS lockbox bank also complied with most security guidelines.*

We also found that, overall, security at the bank was effective.

While these are significant accomplishments, opportunities exist to improve the Philadelphia lockbox program in the following areas:

- Accurate sorting of tax returns (to minimize processing costs and improve customer service).
- Increased oversight on the part of the IRS (to ensure that taxpayer payments and related information are accurately and timely processed).

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### **Overall, Security at the Bank Was Effective**

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The bank was contractually required to provide adequate security, equipment, and facilities to safeguard all taxpayer payments and data received. Although we identified some minor issues related to the use of date stamps and passwords for terminated bank employees, we found that the bank complied with most of the security requirements. For example:

- Security cameras were strategically positioned to monitor the bank entrance, processing areas, and employee locker rooms.
- Security guards were present and monitored the building access.
- Bank employees conducted daily unscheduled desk checks instead of the required weekly checks.
- Police background checks were conducted for all 24 employees reviewed.
- Bank employees wore proper identification badges.
- Couriers were properly authorized to receive and transport deposits and sensitive taxpayer information for the bank.

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### **The Bank Did Not Correctly Sort All Tax Returns**

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The SOW and the Lockbox Processing Guidelines describe the criteria for sorting tax returns. For example, tax returns with tax payments are to be sorted separately from returns that do not have tax payments. From January 2000 through April 2000, the IRS paid the bank approximately \$830,000 to sort over 1 million tax returns.

*The bank did not always sort tax returns correctly.*

Our review of a judgmental sample of 200 tax returns received at the PSPC between June 5 and June 8, 2000, showed that 34 of the returns (17 percent) were sorted incorrectly.

Bank personnel stated that due to the high employee turnover, training had always been an ongoing issue and agreed that the sorting requirements needed emphasizing. When returns are not properly sorted, the IRS must spend additional resources to correctly sort the returns, which could result in processing delays. For example, during the month of April 2000, 60 IRS employees at the PSPC conducted a 100 percent review of over 600,000 tax returns received from the bank to correct sorting errors. The salary costs alone for these employees were approximately \$109,000. The bank was paid over \$654,000 for sorting these same tax returns.

*The bank was paid over \$654,000 for sorting tax returns during April 2000.*

### **Recommendation**

1. The IRS should ensure that the bank correctly sorts tax returns.

Management's Response: Management's response was due on January 25, 2001. As of January 29, 2001, management had not responded to the draft report.

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**The Internal Revenue Service Did Not Provide Adequate Oversight of Bank Activities**

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The IRS lockbox coordinator was required to conduct on-site visits to the bank during April and at least two other times during January, June, or September of each year. The coordinator was also required to prepare and submit monthly performance reports and an April Peak Processing Readiness Report to the IRS National Headquarters lockbox personnel. These reviews and reports were required to determine whether the bank was making timely deposits and sorting returns correctly. The reviews were also required to evaluate physical security at the bank and other issues designed to ensure that the bank was in compliance with procedures included in the SOW.

*The lockbox coordinator did not make any on-site visits or prepare and submit monthly performance reports as required.*

During our review, the PSPC lockbox coordinator informed us that on-site visits had not been made and performance reports had not been prepared.

IRS National Headquarters lockbox personnel were aware that the PSPC coordinator was not making the required visits or preparing the monthly reports but took no corrective actions. They advised us that this matter was out of their control because PSPC management does not support the lockbox program. Without these reviews, the IRS cannot rate the bank's performance or determine whether the bank is in compliance with procedures in the SOW.

*Without these reviews, the IRS cannot rate the bank's performance.*

**Recommendation**

2. The IRS should ensure that the PSPC lockbox coordinator conducts the required on-site visits to the bank and prepares and submits required reports.

## **Conclusion**

The Philadelphia lockbox bank correctly processed tax payments and complied with most security requirements. The IRS should improve its oversight of the bank to ensure that the bank adequately provides all contractual services.



**Major Contributors to This Report**

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**Outcome Measures**

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. This benefit will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

Cost savings – Potential; \$109,056 in employee salaries (see page 4).

Methodology Used to Measure the Reported Benefit:

The Philadelphia Submission Processing Center lockbox coordinator advised us that approximately 60 employees worked full time performing the 100 percent review of tax returns sorted by the bank during the April 2000 peak. The employees were grade GS-4 and GS-5 clerks. We based our calculation on 60 GS-4 Step 5 employees for 20 workdays, using salary data from the United States Office of Personnel Management web site. The calculation for the clerks' salary costs follows:

GS-4 Step 5 annual salary including	
General pay increase and locality pay for Philadelphia:	\$ 23,715.00
Staff hours per year:	2,088
Cost per staff hour: (23,715 / 2,088)	\$ 11.36
Cost per staff day: (11.36 x 8)	\$ 90.88
Cost for 1 Full Time Equivalent (FTE) <sup>1</sup> for 20 workdays:	
(90.88 x 20)	\$ 1,817.60
Cost for 60 FTEs for 20 workdays: (1,817.60 x 60)	<b>\$109,056.00</b>

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<sup>1</sup> An FTE is equal to the standard number of hours (2080) one employee can work in a year. This is calculated as 40 hours x 52 weeks = 2080. Note: Calendar year 2000 is a leap year and will have an extra workday (2088 hours).